Solvency Matters

A quarterly report on solvency issues affecting P&C insurers in Canada

Issue 18 - June 2022

Insolvency protection for home, automobile and business insurance customers

From the Desk of the President (Alister Campbell)

Watching the World Wake-up From History

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PACICC Priority Issues: Updates

Mitigating Systemic Risk from Quake

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Emerging Issues (Rozanne Reszel - CIPF)

Rolling the Fire Hoses and Checking the Ladders

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Solvency Analysis (Grant Kelly)

Returning to normal

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New Failures during the COVID-19 Pandemic

(Zhe (Judy) Peng)

In this article, we examine certain P&C insurers in Thailand which had begun to provide COVID-19-related insurance in the early weeks of the pandemic. Due to underpricing and underestimating insured losses, four such insurers became insolvent. ...Continued on Page 10.

Risk Officer's Forum (Ian Campbell)

Upcoming Risk Officer's Forum meetings and webinars

Next Emerging Risks Webinar – Thursday, October 20

Panel 1: Privacy Compliance and Reputational Risk

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Industry Events (subject to confirmation)

September 11-14
RIMS Canada Conference

September 11-14
CIAA Annual Conference

September 15
PACICC Risk Officer's Forum Meeting

September 18-20
National Insurance Conference of Canada (NICC)

October 20
PACICC Emerging Risks Webinar - Privacy Compliance and Reputational Risk

November 1-2
Financial Protection Forum

November
PACICC Risk Officer's Forum Meeting

February 7-8, 2023
CatIQ Connect

From the Desk of the President

Watching the World Wake-up From History - by Alister Campbell

There are few of us indeed who could have anticipated that we would bear witness to a land war in Europe in our lifetimes. Certainly, my father (a teenager during the Blitz and lucky enough to only be called up for service with the RAF in 1946) passed away quite confident that his children and grandchildren would never have to see such horrors. But Russia's unforgiveable invasion of Ukraine is a sobering reminder that history can, and often does, repeat itself. The heroically brave resistance from the (on-paper) overmatched Ukrainians has been complemented by democratic friends and neighbours – including, of course, Canada – who have rushed to provide materiel to enable a stronger defence and (hopefully) eventual victory against the aggressor. Inevitably of course, it is now clear that many nations had inadequate contingency plans for such an event, and in particular are discovering that there is limited spare military hardware available to ship on short notice to an ally in distress. Democracies' resilience is being tested…as are our supply chains and our military capacity. In retrospect, it is obvious that it would have been better to have more "firepower" in reserve.

So, what does any of this have to do with boring PACICC you may ask? I have previously written about the compelling logic of "using times of peace to prepare for war." But the Russia/Ukraine conflict should serve to remind all of us that it is easy to be lulled into a false sense of security by these current "peaceful" times in our industry history – almost twenty years without an insolvency can easily do that. But recent history should not be interpreted as permanent reality. Failure can and will happen again. So, in such tranquil times, it is entirely appropriate to ask questions like – Does PACICC have enough "firepower" in reserve when disaster strikes? Which is exactly the question our Board asked us to answer as our Priority Issue for 2022, when they tasked us with a Review of the Scope, Scale and Uses of PACICC's Compensation Fund.

> **"...in such tranquil times, it is entirely appropriate to ask questions like – Does PACICC have enough "firepower" in reserve when disaster strikes?"**

The PACICC Compensation Fund was the result of an important practical realization by our Board in the late 1990s, drawing upon their very real experience with multiple insolvencies that it had been required to manage. When an insurer fails and the Court-appointed liquidator communicates this fact to all affected policyholders, the percentage of those policyholders who become alarmed is approximately 100%! But if PACICC and the liquidator are able to partner to rapidly refund unearned premiums and can mail cheques to policyholders entitled to such refunds in a matter of just days or weeks, the number of concerned policyholders calling newspapers, politicians and regulators can be rapidly reduced to the much smaller number that have an outstanding claim. PACICC has substantial financial resources to draw upon in the form of Special Assessments on the industry – up to 1.5% of DWP in covered lines of business (roughly $1B CAD) each year. But raising this money takes time – more than 30 days. Simply not fast enough to address the concerns of panicked policyholders. The solution was to create an industry fund that was ready in advance.

Over the course of 1998-2000, the industry contributed seed capital for the current PACICC Compensation Fund via a series of capital levies – roughly $10M a year, where allocations were based on market share in covered lines. That initial Fund of $30M has now grown to roughly $60M (invested entirely in fixed income securities, to optimize liquidity in moments of crisis). But is that enough? Last year, in preparation for our

review, we retained Eckler Ltd to model the Fund's capacity and discovered that the Fund would be adequate to handle some insolvencies – but would not be large enough to handle the first 30-day requirements in the case of a failure of any of the top-70 Member Insurers of PACICC. Bluntly put, our Fund was no longer large enough for its initially intended purpose. This year, in follow-up analysis, Eckler has now also given us an indication of how much financial capacity PACICC would require to handle larger insurer failures. It appears from this work that a more realistic target would be in the $225M-$250M range.

In parallel with this work, and as discussed in prior issues of *Solvency Matters*, PACICC has continued to engage in research regarding the potential systemic implications for our industry of a major earthquake in British Columbia or the Quebec/Ottawa corridor. In last year's update to our systemic risk model, we posed a question regarding the amount that would be required in our Compensation Fund to allow PACICC to avoid the need for a Special Assessment for the first 12 months after the quake – to buy time for the industry to stabilize itself without the additional burden of funding such a cash call. It is important to note that our findings were conclusive. Above the "tipping point" of $35B in insured losses, there is no credible ex ante fund imaginable that would be adequate. But, significantly, we determined that for a quake event which generated between $30B and $35B in insured losses, a Fund of $230M or so could make a big difference in mitigating the risk of systemic contagion.

The fact that these two different research work streams generated similar numbers is of course entirely coincidental. But, as our Board contemplates increases to PACICC's financial capacity as part of a potential upgrade to our "firepower," there now appear to be several good reasons why a target in the $200M-$250M range might make sense. Which leaves one last question to be answered. What is the best and most cost-effective mechanism for funding this potential capacity increase? At PACICC, we have been evaluating a range of options to help our Board answer this question. Reinsurance? Capital levies? Standby lines of credit (like the one originally used to establish PACICC)? Or a mix of some, or all, of these? We have been doing detailed modeling on scenarios involving all of these options for some time. It is worth noting here that our Guest Columnist this issue is Rozanne Reszel, CEO of the Canadian Investor Protection Fund (CIPF), who shares with us details of the "tower" of financial capacity that they have built at CIPF using capital as a base and supplemented with both a standby-line-of-credit and reinsurance (see Page 7).

> **"PACICC's federal and provincial regulatory stakeholder/partners are watching closely to see how our industry chooses to respond to these important questions regarding the adequacy of our financial capacity."**

PACICC's federal and provincial regulatory stakeholder/partners are watching closely to see how our industry chooses to respond to these important questions regarding the adequacy of our financial capacity – for obvious reasons these days, they are very focused on Canada's "financial resiliency" and the effectiveness of our "resolution infrastructure." Last year, we consulted broadly with the industry on the potential for PACICC to purchase reinsurance on behalf of the industry. And we have now been engaging in comprehensive stakeholder surveys with industry leaders across Canada regarding their own perspectives on how best to approach this issue. Our Board reviewed all of these inputs at its recent mid-year Strategic Planning Conference.

Effective stress-testing and contingency planning are central to modern enterprise risk management. Our research has given us a clear understanding of the scope of the risks we face. But there can still be a big gap between understanding the threat…and having the capacity to respond. I believe that ensuring that we have the "firepower" we need to respond to potential threats is essential. We will be updating PACICC Insurer Members on the evolving thinking of our Board on this critical question in the months ahead.

PACICC Priority Issues: Updates

"Permanent Priority" Issue

Mitigating Systemic Risk from Quake

PACICC staff continues to work with Finance Canada to address the largest single risk facing the Canadian P&C insurance industry – systemic contagion caused by a large earthquake. Last year's update to PACICC's P&C Industry Model (entitled "How Big is Too Big? – The Tipping Point for Systemic Failure") has been instructive to PACICC's ongoing work with the Federal Government. The update included detailed scenarios for an event in B.C. and Quebec, as well as sensitivity analysis examining the outcomes of five alternative public policy responses. The results identify the threshold beyond which the industry would be unable to adequately respond, which in turn is a compelling rationale for a Federal Government backstop mechanism as Canada's best failsafe option.

PACICC is working closely with both the Insurance Bureau of Canada (IBC) and the Institute for Catastrophic Loss Reduction (ICLR) on joint research, including the potential impacts on our Model from possible insurance "pool" designs advanced by ICLR and IBC. PACICC has also been liaising directly with the Bank of Canada, OSFI, the Canadian Deposit Insurance Corporation and the Canada Mortgage and Housing Corporation on this file. The Action Plan to address systemic contagion will be revisited annually, until such time as a Federal Government backstop mechanism has been secured and is in place.

Priority Issue – 2021

Contingency Planning and Desktop Simulations

PACICC's 2021 Priority was to develop Contingency Planning and Desktop Simulation exercises with Regulators. Proper emergency preparedness calls for the road-testing of response procedures to ensure their relevance and readiness when the call for help arrives. PACICC staff has been working to test the Corporation's Contingency Plans through a series of desktop simulation exercises with staff from OSFI in 2021 (ongoing in 2022), and the AMF (completed in January 2022).

A. OSFI Desktop Simulation is Well Underway:

The planned 2021 desktop simulation with OSFI continues. An interim status report on lessons learned was presented to the PACICC Board at its April meeting. These included:

- PACICC must strengthen its commitment to confidentially handling information provided by regulators
- Established TLS encryption on emails between PACICC and OSFI
- Regulators continue to seek clarity on the effectiveness of PACICC's governance structure

In April 2022, PACICC and OSFI tested the Corporation's new Resolution Protocol. The Pre-Insolvency Regulatory Liaison Committee considered two proposals to "resolve" the hypothetical insurer. One of these proposals met all the requirements of the Resolution Protocol and was approved by the PACICC Board of Directors.

The simulation will continue to allow PACICC and the regulator to test all phases of the Corporation's preparedness.

B. AMF Desktop Simulation Completed

The PIRL Committee completed a half-day simulation with AMF on January 30, 2022. A report on lessons learned is attached.These include:

- PACICC must strengthen its ability to communicate in French
- PACICC enjoys a strong working relationship with regulatory staff
- PACICC needs to establish contact with AMF's Communication and Legal teams to ensure effective pre-planning for crisis scenarios

In addition to these lessons, regulatory feedback in designing these simulations led to the changes in the Memorandum of Operation approved by the Board at its November 2021 meeting. These changes allow PACICC to access the money in the Compensation Fund to fund alternatives to liquidation.

Priority Issue – 2022
Review the Scope and Scale of PACICC's Compensation Fund

PACICC's Priority Issue for 2022 is to complete a formal review of the scope, scale and mandate of the Compensation Fund. The Compensation Fund was established in 1997 to ensure the Corporation's capacity to respond immediately to the needs of affected policyholders after an insolvency, without any delay while waiting for required funds to be collected via a PACICC General Assessment.

The purpose of this report is to update the PACICC Board on progress, to answer the following questions that form the core of the Board-approved workplan:

1. What is an appropriate size for the PACICC Compensation Fund?
2. What sources of financing are available to PACICC to collect this amount?
3. How can PACICC best leverage the funds in the Compensation Fund to achieve its mission?

1. What is the appropriate size of funding needed by PACICC?

The Compensation Fund was initially created so that PACICC could quickly process unearned premium rebates to consumers. The rationale was to rapidly remove the vast majority of policyholders from the legal process. In 1997, the PACICC Board of Directors set a Compensation Fund target of roughly $30 million. The funds were collected through a series of industry capital levies – $10 million a year – over a period of three years, from 1998-2000 – with each PACICC Member's Assessment being equal to 0.15% of its net written premiums during 1997. The Fund is managed for PACICC by CIBC Asset Management, overseen by PACICC's Audit & Risk Committee and governed by a strict Investment Policy focused exclusively on fixed income securities, with a high priority placed on security and liquidity. As of December 31, 2021, the market value of the Fund was $58.9 million. PACICC has not used the money in the Fund since its inception.

Only the PACICC Board of Directors can authorize the use of funds in the Compensation Fund. The Memorandum of Operation requires that any Compensation Funds used be reimbursed, via an assessment on Member Insurers.

In 2022, Eckler ranked PACICC Members by size, based on direct premiums written (DPW). The Members were divided into cohorts of 15. The first column estimates the size of Fund needed to refund only unearned premiums for the average Member Insurer in this grouping. The second column estimates how large of a Fund PACICC would need to refund unearned premiums and pay six months of claims before assessing Member insurers.

	millions of dollars	
PACICC Member Insurers ranked by size (DWP)	**Refund ONLY unearned premiums**	**Refund unearned premiums plus 6 months of claims**
15 Largest Members	$940	$1,844
Members 16-30	$242	$511
Members 31-45	$135	$252
Members 46-60	$92	$168
Members 61-75	$59	$124
Members 76-90	$34	$81
Members 91+	$7	$19

Key findings are that our current Fund is not of a size adequate to respond fully (unearned premiums and six months of claims) to the failure of any of our largest 90 Members. Interestingly, we would also be unable to respond effectively to the failure of any of the 15 largest Branches.

2. What sources of financing are available to PACICC to collect this amount?

There are three ways that PACICC would be able to raise funds – if required. They are:

1. Assessment of Members: PACICC's Memorandum of Operation (MoO) allows PACICC to collect additional funds from Member Insurers. The Board may set a rate based on future direct premiums written (DPW). The rate set in 1999 was 0.15%. This requires a special vote of the Board, with two-thirds of PACICC Members giving their approval
2. Borrowing – PACICC's MoO and By-Laws allow the Corporation to borrow as required
3. Reinsurance – PACICC's MoO and By-Laws allow the Corporation to purchase reinsurance as required

3. How can PACICC best leverage the funds in the Compensation Fund to achieve its mission?

The MoO restricts the uses of the Compensation Fund to paying compensation to policyholders or (since April 2022) funding alternatives to liquidation. The MoO also requires that, if the Fund is used, then it must be replenished by an assessment of Member Insurers.

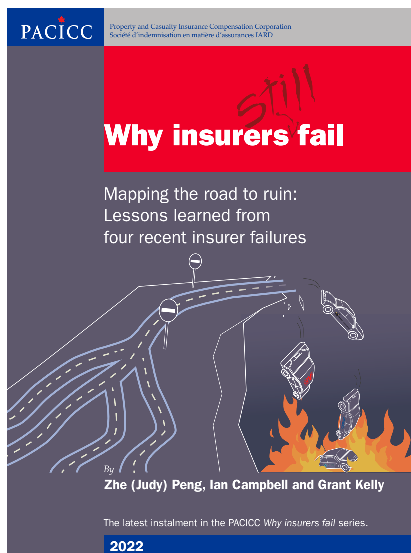
PACICC staff continues to investigate how the Fund can best be used to advance the Corporation's mission, including:

- As collateral, allowing PACICC to issue a guarantee?
- As a potential source of funds for reinsurance purchases?
- As the source of funds for capitalization of a PACICC Corp (a bridge insurer)?

PACICC staff provided a detailed overview of options to the Board at its Strategic Planning Conference on June 9. Formal proposals will be prepared for Board consideration at the November 3 Board Meeting.

New PACICC Report Available

Why Insurers Fail – Mapping the road to ruin: Lessons learned from four recent insurer failures



The Property and Casualty Insurance Compensation Corporation (PACICC) has released the latest study in its ongoing *Why Insurers Fail* research series entitled, "*Mapping the road to ruin: Lessons learned from four recent insurer failures*."

This study, authored by PACICC staff members Zhe (Judy) Peng, Ian Campbell and Grant Kelly, contains short reports covering the recent failures of four insurance companies. Each report examines the history of the company and why it failed. The study then outlines lessons that can be learned from the failure and compares causes of the failures to those of other failed insurers examined in past PACICC studies.

Alister Campbell commented, "Canadian policyholders have been blessed with almost two decades since the last insurer failure in our country. But, as this new research paper powerfully illustrates, insurers in developed economies around the world can, and do, still fail. This report highlights the reality that traditional causes of insurer failure can still trigger default, even in sophisticated financial systems with substantial supervisory regimes. And this important research adds a critical new insight – a changing climate presents new solvency risk for insurers in other countries and adds to the threats against which we all must remain vigilant here at home."

Copies of all *Why Insurers Fail* studies are available on the PACICC website (www.pacicc.ca).

Emerging Issues

Rolling the Fire Hoses and Checking the Ladders

by Rozanne Reszel

Canadian Investor Protection Fund
Fonds canadien de protection des épargnants

What does an insolvency compensation fund do between insolvencies? At CIPF we communicate our coverage, monitor the overall health of our member firms and ensure we have adequate resources to provide the protection we hold out to customers of our member firms. We must always be "fire house ready."

Insolvencies of investment dealers are unpredictable and fortunately, infrequent. CIPF has provided payments to customers in 21 insolvencies over 53 years. The industry is highly regulated by the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC). Adequate regulatory capital must be maintained at all times and is reported monthly to regulators, self-regulatory organizations and CIPF.

So, how do insolvencies happen? They can result from inaccurate reporting, from event risk, and sadly, occasionally, as a result of fraud.

While human optimism, malfeasance and event risk cannot be predicted, CIPF determined that a credit-risk based model was an appropriate tool to calculate the likelihood of a member firm failing and the resulting liquidity exposure to CIPF. Adding these exposure calculations together allowed us to project how large our liquidity resources should be. A related objective was to allocate our annual assessment to member firms on a risk basis.

When CIPF adopted a credit-risk based approach to determining its total liquidity resources, it also changed the basis of its assessments from a revenue basis to a measure of the expected loss reflecting the market value of customer assets held by the member firm. This was a more relevant indicator of exposure at default since the CIPF Coverage Policy returns customer property including cash, securities and bonds.

However, it also increased the assessments on member firms holding customer assets and reduced assessments on member firms that were largely institutional in nature. In order to make this transition feasible at a member firm level, the CIPF Board determined that it would reduce the total annual assessment from $30 million to $10 million and provide a transition period for member firms who would experience increased assessments, to adjust.

> **"CIPF plays an important role in the regulatory continuum that protects investors, by returning customer property if one of our member firms fails. Communicating that message effectively contributes to the health and confidence of all participants in the capital markets in Canada."**

To supplement the assessments, the bond portfolio and line of credit that CIPF maintained, CIPF obtained insurance from the London market. The London market had historically provided “excess of CIPF coverage” to individual member firms. Taking the product to the compensation fund level on behalf of all member firms, was a new concept and was achieved by working with our insurance agent and the lead underwriter of a syndicate. This product has now been purchased by other compensation funds globally.

Today CIPF maintains slightly more than $1 billion in liquid resources comprising a bond portfolio of government and provincial bonds of $525 million, a committed line of credit of $125 million with two Canadian chartered banks, and $440 million of insurance in two tranches, accessible in any year that CIPF pays over $200 million in claims.

The line of credit allows time to determine an estimate of the total advances that may be required from CIPF to permit a bankruptcy trustee to transfer customer accounts from an insolvent member firm to an active member firm. If the debt market conditions are unsettled, it also prevents the need to sell bonds into a volatile market.

> **“The line of credit allows time to determine an estimate of the total advances that may be required from CIPF to permit a bankruptcy trustee to transfer customer accounts from an insolvent member firm to an active member firm.”**

CIPF has continued to refine its credit-risk based model by risk ranking the location of securities held for clients. It became apparent in the MF Global insolvency that assets outside Canada, that were held directly in the Canadian member firm’s name were easier for a bankruptcy trustee to access than assets held indirectly through an affiliate. We were also reminded that in insolvency scenarios, once you cross the border into another jurisdiction, that jurisdiction’s bankruptcy laws apply, and our trustee’s claim could be subordinated to others.

Our model is recalibrated every two to three years to incorporate monthly industry data since the last time it was recalibrated. The objective is to find the most predictive combination and weights of input factors. The model relies on historic data and does not project the impact of economic scenarios.

Understanding the impact of volatile markets on our member firms requires CIPF to have a deep understanding of member firms’ business models. For example, 97 of approximately 170 member firms introduce their business to a carrying member firm, which allows them to convert a large portion of fixed expenses for administration, to variable, based on business volume.

CIPF plays an important role in the regulatory continuum that protects investors, by returning customer property if one of our member firms fails. Communicating that message effectively contributes to the health and confidence of all participants in the capital markets in Canada.

Solvency Analysis

Returning to normal

by Grant Kelly

The past issue of Solvency Matters cautioned insurers that the industry's current, high profitability was likely unsustainable and noted that profits were cut in half within only two years of previous peaks, since 1975. The industry's first-quarter financial results suggest that history could indeed be repeating itself. Industry return on equity was 11.5 percent in the first quarter of 2022, compared to 19.0% in the same period in 2021.

However, the decline in profitability was entirely due to a large decline in investment income. Canada's P&C insurers reported $1.058 billion less in investment income in the first quarter of 2022, compared to the same period in 2021. This large decline is primarily due to the increase in interest rates in the first quarter of 2022. P&C insurers hold most of their invested assets in bonds. As interest rates rise, the value of the industry's bond portfolio declines. While this is not good news for short-term investment results, we note that most insurers will likely hold these bonds until they mature. This means that reported losses are "temporary or paper" losses that may not erode the industry's long-term capital base.

Problems on the investment side overshadowed the continued strength in underwriting results. The combined ratio in the first quarter of 2022 was 79.2 percent. This is actually an improvement from the very strong 81.2 percent reported in 2021. So, any "reversion to the mean" for industry loss ratios does not yet appear to have begun.

Underwriting results were very strong in all of the industry's major lines and markets. The Auto insurance loss ratio was 45.5 percent in the first quarter of 2022, compared to 53.1 percent reported in the first quarter of 2021. The loss ratio for Homeowners insurance was 50.8 percent. While this is slightly higher than the 46.0 percent reported in 2021, the 2022 results are still remarkable because of the consistency of the result across Canada's broad geography. In fact, the only outliners to the good news were in Newfoundland and Labrador (loss ratio of 95.1 percent) and Prince Edward Island (loss ratio of 84.1 percent).

Commercial lines also reported very strong underwriting results in the first quarter of 2022. The loss ratio for Commercial property was 48.6 percent in Q1 2022, which was higher than the 42.4 percent reported in 2021. However, 2021 saw the industry's lowest loss ratio ever reported for this line of business in the PACICC database. When sitting at a peak, there is often nowhere to go but down. But in this case, the industry does not yet appear to be suffering…with results only declining within a historically profitable range.

Needless to say, we await upcoming quarters results with great interest.

2022 Q1 Financial Year Results

($ millions)	2022	2021	Percentage Change
Direct Premiums Written (DPW)	$16,503	$14,967	10.3%
Net Pemiums Earned (NPE)	$12,847	$13.426	-4.3%
Net Claims Incurred	$5,615	$6,715	-16.4%
Operating Expenses	$4,557	$4,282	7.2%
Underwriting Income	$2,747	$2,508	9.5%
Net Investment Income	-$315	$744	-147.7%
Net Income	$1,530	$2,289	-33.2%
Combined Ratio	79.2%	81.7%	
Net Loss Ratio	43,7%	50.0%	

Source: MSA Research as of May 26, 2022.

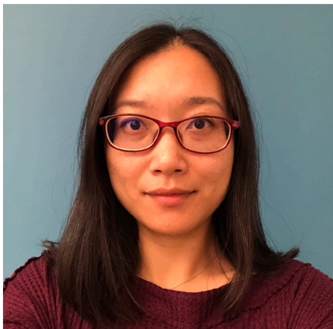
Values exclude mortgage insurers

Select Solvency Indicator Ratios

($ millions)	Q1 2022	Q1 2021
Average Equity	$53,081	$48,114
Return on Equity (ROE)	11.5%	19.0%
Return on Investment (ROI)	-1.3%	3.0%
Comprehensive ROE	11.5%	19.0%
Comprehensive ROI	-8.3%	2.1%
MCT Ratio (Capital Available/Capital Required)	254.0%	264.6%
BAAT Ratio (Net Assets/Capital Required)	291.6%	315.8%

New Failures during the COVID-19 Pandemicc

by Zhe (Judy) Peng



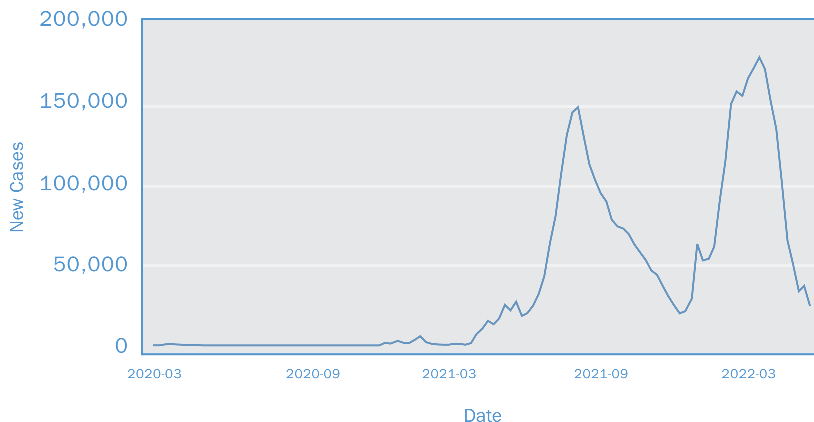
In this article, we examine certain P&C insurers in Thailand which had begun to provide COVID-19-related insurance in the early weeks of the pandemic. Due to underpricing and underestimating insured losses, four such insurers became insolvent.

More than two years have now passed since the World Health Organization (WHO) declared that COVID-19 had become a global pandemic (on March 11, 2020). During this period, lockdown restrictions imposed by governments around the world significantly reduced on-site business operations and individual activities substantially, resulting in many economies entering a mild economic downturn. While many businesses experienced a loss of revenue, some insurers in Thailand saw a new business opportunity: offering insurance against COVID-19-related risks.

In developed markets, offering pandemic coverage may have seemed unnecessary. In Canada and the US, governments provided generous support packages to employees and small enterprises, including temporary pandemic pay, tax rebates and relief funds.

However, in developing countries, where job security is often less certain and financial support from the government is generally lower, residents had incentive to seek pandemic insurance coverage from private insurers. On the P&C insurers' side, COVID-19-related risk – a form of personal accident insurance – seemed to offer underwriting potential. In Thailand, a market with a population of 68 million people and more than 50 non-life insurers, the total number of reported cases of COVID-19 was only 6,884 by the end of 2020. This number was less than 2% of that in Canada, despite the fact that Thailand's population was substantially higher.

Figure 1: Weekly New COVID-19 Cases in Thailand (March 2020–May 2022)



Source: Calculated from the data provided by CSSE at Johns Hopkins University

Recognizing the potential demand, 16 Thailand insurers began to underwrite COVID-19-related policies in early 2020. According to news reports, the annual premium for a typical COVID-19 policy could be as low as 300 baht (around 11 Canadian dollars) with maximum coverage generally ranging from 50,000 baht to 300,000 baht (around $1,850 to $11,000 CAD).

By way of example, from February to April of 2021, a market leader in Thailand – Southeast Insurance – sold two plans under the name "COVID-19 Secure Insurance" to customers. The broker of the plans, equally reputable, was the Siam Commercial Bank (SCB), the largest commercial bank in Thailand. In retrospect, the two plans proved to be fundamentally underpriced. The basic plan, costing 519 baht ($19 CAD), offered 100,000 baht ($3,670 CAD) of maximum coverage; the premium plan, with a premium of 1,037 baht ($38 CAD), offered a maximum coverage of 200,000 baht (around $7,340 CAD). Both plans offered policyholders a lump-sum payment once an infection was confirmed (known as "Jer Jai Jop" policies).

Profits from the sale of these plans were initially very strong. Industry premiums collected in this class of risk totaled 4.2 billion baht in 2020, while claims payments were only 70 million baht. And in 2021, direct premiums from the policies reached 6.2 billion baht, accounting for more than 12% of the total direct premiums collected from all personal accident and health lines.

Zhe (Judy) Peng is a Reseach Assistant at PACICC

However, over time, the COVID-19 policies became increasingly problematic as the impact of COVID-19 increased in Thailand. The high infection rate of the Delta and Omicron variants far exceeded the actuarial model expectations of the insurance providers and rapidly depleted the profits earned earlier. As Figure 1 shows, in 2021Q3 and 2022Q1, new cases in some weeks reached as high as 150,000. This sudden increase in infected individuals, and widespread availability of policies that offered quick, lump-sum claims, caused immediate and massive underwriting losses. In December 2021, the Thai General Insurance Association (TGIA) estimated that the Thai insurance industry had incurred a net loss of some 25 billion baht in 2021.

Table 1: Profit and Loss in the Thai Insurance Industry

Year	2017	2018	2019	2020	2021 (estimate)
Profit/Loss (in billion baht)	5,949	4,938	2,290	12,370	-25,000

Source: Thai General Insurance Association (TGIA)

As a result of surging claims in the second half of 2021, two P&C insurers – Asia Insurance 1950 PCL and The One Insurance PCL – had their licences revoked (on October 5 and December 13, respectively). On April 1, 2022, Southeast Insurance and Thai Insurance, both subsidiaries of Thai Group Holdings (TGH), also lost their insurance licences. At that time, TGH itself reported a net loss of 3.360 billion baht ($123 million CAD) in 2021.

Before the failures of its two subsidiaries, TGH requested that the Office of the Insurance Commission (OIC) – the Thai insurance regulator – cancel the outstanding lump-sum policies. Two other insurers (Syn Mun Kong (SMK) Insurance and TGIA) also made the same request. But the OIC concluded that non-payment of claims was a serious violation of law and trust, and therefore rejected the cancellation proposal. At the same time, OIC issued urgent waiver orders on eligible insurers in September 2021, allowing them to deviate slightly from their capital requirements. But this regulatory flexibility proved inadequate to save a handful of the insurers active in this line of business (See Table 2 below).

Table 2: Four Failures in Thailand

Failed Insurer	License revoked on	Notes
Asia Insurance 1950 PCL	October 15, 2021	The audit reported an equity of -1,543.06 million baht (56.53 million)
The One Insurance PCL (formerly Assets Insurance)	December 13, 2021	By March 2022, covid-related premium was 11 billion baht, but the payment claims totaled 60 billion baht.
Southeast Insurance PCL	April 1, 2022	Existing policies transferred to Indara Insurance, a firm under its parent, TGH; Owed 13 billion baht in claims payment
Thai Insurance PCL	April 1, 2022	Owed 4.6 billion baht in claims payment

Notes: PCL = public company limited

Source: Bangkok Post, Insurance Business, and Milliman

Although Thai insurers have stopped issuing new COVID-19 policies, the trouble caused by their hasty entry into the uncharted waters of pandemic insurance has not ended. As TGIA and Milliman have revealed, some 80% of the existing COVID-19 policies written in 2021 were sold in 2021Q2. This means that insurers will have to wait until the end of June for full losses to materialize.

The failures in Thailand caused concern in another market that is also exposed to increasing COVID-19 claims against similar policies: Taiwan. Some insurers have decided to stop making payments. However, the regulator has not yet determined its response.

As the example of Thailand shows, best practice in insurer risk management can be compromised when “fortune” knocks at the door. And when that fortune is tied up with an emerging risk, what may at first seem attractively sweet can turn out to be unpleasantly sour. Despite the ever-increasing rigour of prudential oversight, P&C insurers do still fail. Regulators must continue to reflect on what trade-offs to make in order to balance insurer appetite for risk-taking and innovation with the need to ensure insurer solvency and overall soundness of the financial system.

PACICC Risk Officer’s Forum

Upcoming Risk Officer’s meetings and webinars - by Ian Campbell

The Risk Officer’s Forum seeks to enhance risk management within the P&C insurance industry by:

- Discussing and sharing risk management best practices within the industry
- Reviewing and communicating topical risk management information
- Serving as a risk management resource for PACICC and for insurance regulators
- Discussing major existing risks and significant emerging risks within the industry
- Providing resources and information to facilitate research of risk management and related governance topics.

Risk Officer’s Forum Meetings

Forum Meeting include a keynote speaker on a topical industry issue, followed by industry/expert presentations on current ERM issues.

2022 Forum Meeting Dates:
Speakers being confirmed…

Thursday, September 15

Keynote:	CEO Perspective on the Risk Function
Discussion Panel 1:	Inflation Risk
Discussion Panel 2:	Human Resources and Talent Management

November* (Date to coincide with OSFI’s Risk Management Seminar)

Keynote:	Highlights from PACICC Strategic Planning Conference
Discussion Panel 1:	Class Action Litigation (Status/Update)
Discussion Panel 2:	Supply Chain Risks

Emerging Risks Webinars

Three Emerging Issues Webinars are held each year, connecting Forum members across Canada in a deep-dive discussion on technical aspects of a specific ERM issue.

2022 Emerging Risk Webinar Date:
Speaker being confirmed…

Thursday, October 20

Topic:	Privacy Compliance and Reputational Risk

For event registration information (pre-registration is required) or to be included in future Risk Officer’s Forum member advisories, please contact Ian Campbell, Vice President, Operations, PACICC at icampbell@pacicc.ca or 416/364-8677, Ext. 3224.

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